INTERNATIONAL RESEARCH JOURNAL OF MULTIDISCIPLINARY STUDIES

Vol. 3, Issue 8, August, 2017| ISSN (Online): 2454-8499 | Impact Factor: 1.3599(GIF), 0.679(IIFS)

Study of Direct Tax Code (DTC) as a Next Step of Tax System Reform

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Abstract:
India is going through the phase of revolutionary changes in economic as well as administration system. Introduction of Adhaar Card was a start of all such revolutionary practices. Adhar was initially a part jokes on the government, but it has proven to be one of the important part of the all correspondence, application and identity of an individual; citizen of India. Government has introduced many innovative practices like Adhaar, most of the government departments are controlled with MIS and by National Information Council (NIC). The administrative practices are dominated by Enterprise Resource Planning (ERP) software. The Public Revenue Revolution was actually planned in 20th century but due to some legal and constitutional constraints, it could not work. The Tax Revolution was planned with Direct Tax Code (DTC) first and was followed by Goods and Service Tax (GST). Practically GST is just implemented and the next step should be implementation of Direct Tax Code (DTC). Direct Tax Code will have deeper impact on the economy if it is implemented with the planned technological administration. This paper will highlight the SWOC analysis of the probable implementation of Direct Tax Code.

Key Words: Direct Tax Code (DTC) , What After GST, Tax Revolution in India.

I. Introduction:-

India wants to upgrade its direct tax laws, its income tax act which is now nearly 50 years old. The government wants a modern tax code in step as the need of economic dynamism. India is the third largest economy in the world. The current tax system for direct taxes is complex and comprehensive to give justice to all parts of the society. As far as Income Tax Act 1961 is concern it is so complicated and requires regular update and very difficult to understand for a normal citizen, but as far as DTC is concern it is very easy and comprehensive to understand which will make good impact. New Direct Tax Code which has been announced by the then Finance Minister Pranab Mukherjee, which was supposed replace the current Income Tax Structure from the Financial Year 2011-2012.The draft Direct Taxes Code (DTC) was released in August, 2009. Since then, a number of valuable inputs on the proposals outlined in these documents have been received from a large number of organizations and individuals. These inputs have been examined and the major issues on which various stakeholders have given their views have been identified. The DTC could not reach to its level amended drafts in 2010, 2012 and then new draft of GST came in to public in March 2014 which was called DTC 2013 and was buried by Finance Minister in his Budget speech of Feb 2014. The Original Direct Tax Code was really very simple and straight forward but it was challenging to implement the same as it is, hence the FM Arun Jaitley has changed it to a different format. There are a number of other issues which have been raised in the public feedback, which will be considered while finalizing the Bill for introduction in Parliament.

The first draft Direct Taxes Code (DTC) was released in August, 2009. Since then, a number of valuable inputs on the proposals outlined in these documents have been received from a large number of organisations and individuals. These inputs have been examined and the major issues on which various stakeholders have given their views have been identified. This paper highlights these issues as a SWOC analysis of Direct Tax Code 2013

Income has been proposed to be classified into two broad groups Income
From Ordinary Sources and income from Special Sources

• Income from Ordinary Sources refers to
- Income from employment
- Income from house property
- Income from business
- Capital Gains
- Income from Residuary Sources

• Income from Special Sources to include specified income of non-residents,
Winning from lotteries, horse races, etc.

• Losses arising from Ordinary sources to be eligible for set off or carry forward
And set-off against income only from ordinary sources without any time limit.
Similar treatment for set off and carry\ forward of losses from Special sources.

II. Highlights of Direct Tax Code :

1. All Direct Taxes are integrated as a single Act.
2. Previous year and Assessment year concept will be removed.
3. Tax audit ceiling will remain the same.
4. VRS Gratuity and commuted pensions, taxable if not invested in approved savings, will be taxable on withdrawals.
5. Government and Non-Government Taxation Difference removed.
6. Share Profit will be as usual, STT to be abolished.
7. Capital Gains reinvestment will be allowed for One residential house and in Agricultural land.
8. No carry forward of MAT credit. Limits on remuneration and interest to partners removed.
9. Returns to be processed within one year, otherwise no demand notice can be raised.
10. Tuition fees for children will be allowed to Individuals and HUF.
11. Savings limit eligible for deduction increased to Rs. 3 lakhs from the current Rs. 1 lakh.
12. Deductions like 80D, 80DD, 80DDE, 80U, 80E, 80 GG retained.
13. Deductions for Co-operative societies, copyright royalties, patents are retained.
14. Two types of sources of income Ordinary Sources and Special Sources
15. Separate computation of income from ordinary and special sources
16. Income from special sources includes items such as investment income, royalties, FTS and dividend income exceeding Rs. 1 crore for resident shareholders.
17. DTC 2013 has the big list of special source income
18. Income under special sources will be taxed at specified rates without deduction for expenses
19. Dividend Distribution tax at 15%
20. proposes a rate of 30% in DTC 2013 surcharge and education cess not mentioned
21. Foreign companies also be taxed at 30% in DTC 2013

Vol. 3, Issue 8, August, 2017| ISSN (Online): 2454-8499 | Impact Factor: 1.3599(GIF), 0.679(IIFS)

22. Additional Branch profit Tax introduced, the same is at 15%
23. MAT is at 18.5% of book profits in DTC 2013
24. Carry forward of MAT is available for 10 years in DTC 2013,
25. DTC 2013 proposes tax on dividend income exceeding Rs 1 crore in the case of residents; since dividend income exceeding Rs 1 crore will be categorized under income from special sources no expense deduction will be possible:
26. This will have to be paid in addition to the DDT
27. Will have cascading effect for companies having holding subsidiary structures
28. Income to be taxed at 10% if divided income exceed Rs1 crores
29. Is the amount exceeding Rs1 crore to be taxed at 10% or the full aggregate amount.
30. The same should be clarified.
31. Under the ITA dividends distributed are taxed at 15% excluding surcharge and cess and there is no tax in the hands of the shareholders
32. DTC 2013 proposes tax on dividend income exceeding Rs 1 crore in the case of residents; since dividend income exceeding Rs 1 crore will be categorized under income from special sources no expense deduction will be possible:
33. This will have to be paid in addition to the DDT will have cascading effect for companies having holding subsidiary structures
34. Computation methodology for indirect transfer to be clarified
35. Wealth tax includes all assets are covered including financial assets
36. DTC 2013 proposes tax on indirect transfer of value exceeds the prescribed amount
37. DTC 2013 proposes wealth tax at the rate for Individuals and HUF is 0.25% on Net Wealth exceeding Rs 50 crores
38. Foreign company is considered to be resident in India if its Place of Effective management (POEM) at any time in the year is India
39. DTC 2013 has reduced the weighted deduction for research and development
40. DTC 2013 has no deduction for CSR, whereas the new Companies Act has made CSR mandatory for corporates
41. DTC 2013 has proposed to widen the scope of the definition of “Accountant” to include other professionals as well.
42. Tax neutrality on conversion of partnership firm into LLP/Company
43. Standard Deduction for house property reduced to 20%
44. Controlled Foreign Company (CFC) Rules
45. These rules were introduced to limit the tax deferral. Undistributed income earned by the CFC is included as income of the resident shareholder under certain circumstances.
46. The total income of a resident tax payer will include income of CFC and CFC is defined as a resident of a territory with lower rate of taxation and which is not engaged in active trade of business and more than 25 percent of its income comprises passive income (dividend, interest).
47. DTC 2013 also empowers government to notify country or territory as not being a territory with a lower rate of taxation.

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III. **SWOC Analysis of Direct Tax Code:**

The SWOC analysis includes an analysis of strengths, Weaknesses, Opportunities and Challenges. It is an overall analysis. The strengths are powers to encounter opportunities and it is challenge to overcome the weaknesses. Such scientific way of looking at DTC will enlight the ultimate effect.

Income from Ordinary Sources and income from Special Sources

A) Income from Ordinary Sources refers to

1. Income from employment
2. Income from house property
3. Income from business
4. Capital Gains
5. Income from Residuary Sources.

B) Income from Special Sources to include specified income of non-residents, winning from lotteries, horse races, etc. Losses arising from Ordinary sources are to be eligible for set off or carry forward and set-off against income only from ordinary sources without any time limit. Similar treatment for set off and carry\ forward of losses from Special sources.

a) Strengths

1) Use of technology will enable more transparency in public revenue system. Adhaar enabled system of tax calculation and transaction tracking system will make people pay tax.
2) Most of the alternations are as per the international standards and hence will be easily accepted by multinational companies.
3) Complexity of tax is reduced to some extent.
4) Conversion of Income Tax Act to Direct Tax Code make a mandatory change in the system of tax collection and implementation of tax rules.
5) The DTC has proposed a Minimum Alternate Tax (MAT) on companies calculated with reference to the "value of gross assets". The economic rationale for the assets tax is that investors can expect ex-ante to earn a specified average rate of return on their assets; hence it provides an incentive for efficiency.
6) Minimum Alternate Tax (MAT), a company would ordinarily be liable to pay tax in respect of its total income. However, owing to tax incentives, the liability on total income, in many cases, has been found to be extremely low or even zero. Internationally, a variety of economic bases and methods are used to calculate presumptive income so as to overcome the problem of excessive tax incentives.
7) The DTC proposes to abolish Securities Transaction Tax. Therefore, all capital gains (loss) arising from the transfer of equity shares in a company or units of an equity oriented fund will form part of the computation process described above, which is going to give an enrichment for the stock market trading
8) A foreign company is considered to be a resident in India if its place of controland management at any time during the year is situated wholly or partly inIndia. Income from the transfer, directly or indirectly of a capital asset situated inIndia shall be deemed to accrue in India. Income would be deemed to accrue in India even if the

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payment is made Outside India or services are rendered outside India and in other stipulated cases.

9) The GAAR provisions apply where a taxpayer has entered into an arrangement, the main purpose of which is to obtain a tax benefit and such arrangement is entered or carried on in a manner not normally employed for bona-fide business purposes or is not at arm's length or abuses the provisions of the DTC or lacks economic substance. The Assessing Officer in accordance with the directions of Commissioner of Income Tax may in such cases determine the tax consequences for the assesse by disregarding the arrangement
10) DTC is the real tax relief to an individual, almost 98% of Indians will then pay 10% or less tax, fear of tax will be drawn out of the mind of citizen of India.
11) Deduction limit of savings and investments is proposed to be increased
12) Reduction in Corporate Tax rates will enable the companies to save the tax and re-invest the same or enable high rate of dividend, this will be motivation for investor in capital market
13) Remarkable reduction in wealth tax will make the people comfortable to declare the property
14) The DTC 2013 will be more towards system oriented tax calculation.

b) Weaknesses

1) The Standard Deduction from the income from house property, will create an additional burden on the public who are retired and surviving only on house rent income.
   i. Amount of any interest payable on capital borrowed for the purposes of acquiring, constructing, repairing, renewing or re-constructing the property will not be considered for self-occupied property as a deduction will again increase the tax burden and the real estate industry will have to face a problem.
   ii. The income from property shall include income from the letting of any buildings along with any machinery, plant, furniture or any other facility if the letting of such building is inseparable from the letting of the machinery, plant, furniture or facility.
2) Direct Tax Code (DTC) deals with tax incentives for savings. It proposes the "Exempt-Exempt-Taxation‟ (EET) method of taxation for savings. Under this method, the contributions towards certain savings are deductible from income (this represents the first 'E' under the EET method), the accumulation/accretions are exempt (free from any tax incidence) till such time as they remain invested (this represents the second „E‟ under the EET method) and all withdrawals at any time are subject to tax at the applicable marginal rate of tax (this represents the "T‟ under the EET method).
3) Cash transactions accountability is challenged by way of rejection in cometax calculation.
4) Leave encashment received at the time of retirement or in service which was partially exempted to non govt employees will be taxable for employees in the DTC.
5) All types of medical facilities which are partially exempted from tax are now taxable
6) Financial securities and shares are considered as the wealth and taxable under wealth tax.

c) Opportunities

1) Crystal clear tax system will get established and It will decrease tax evasion tendency and motivate the individual to pay tax and show their real income
2) DTC does not allow the exemption on saving so that tax saving planning will not be necessary and public will be in practice to pay the tax.
3) Long term investment and retirement benefit account are given a scope to increase as well as the TEE system will be beneficial to the retired persons.
4) Free flow of money in the stock market will increase the trading and capital investments in the stock market so as to ensure the development of the nation, as Service Transaction Tax is abolished.
5) Lowering the corporate tax will be a relief to the corporate world and will result in growth of companies will take place.
6) Increase in the wealth tax limit allows the public to create wealth and maintain the same.
7) Limit of 20,000 cash with drawl will increase the bank transactions and reduce the black money to come in the market.

d) Challenges

1) Employee benefits are reduced hence the common man will look at the tax system with negative approach. The government has to convince them about the benefits given to them and increase some benefits for employed common man.
2) It is possible to hamper banking business, Real estate Business and material to real estate supplies as the interest on housing loan is not considered for deduction under the self-occupied property. The *Jan Ghar Yojana* which government has will conflict this policy of the government. .
3) MAT may be increased due to charging on gross assets instead of book profitsInvestment will decide the incentive not the area.
4) The conflict of CSR in Company Law and CSR expenditures in DTC need to be resolved. It will need strong public support to make CS possible without granting exemption to CSR expenses in Income tax calculation.
5) Indefinite carry forward of business losses to be allowed. May create manipulation in the corporate world.
6) The important challenge is to introduce an internationally aliened tax system in the completely deviated population. The tax system which is proposed in DT2013 has strong base of charging the tax and lower base of granting exemptions, whereas in India still inequality is a part of customs, laws, politics administration and legislation as well. It will be a real challenge for the government to implement such a strong system of taxation without public support. .
7) The Government has chosen the GST to be implemented first. The impact of GSt will definitely matter for the acceptance and approach toards implementation of DTC in public.

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Conclusion:

In new global scenario the government wants a direct tax code to be implemented in systemic manner as a need of an economy. The new tax code is expected to widen the tax base, end of unnecessary exemptions, moderate tax rates and add to the government's coffers.The code bill will provide greater tax clarity and stability to investors, those who want to invest in Indian projects and companies. The government has marginally lowered the tax burden for individuals and has effectively left corporate with largely similar tax rates as before, hoping that these changes will make the new code revenue positive. Code will replace the archaic Income Tax Act and simplify the whole direct tax regime in the country.

Thus, DTC has some strength, weaknesses, opportunities and threats. The DTC is surely a bold step towards tax reforms. It will be more beneficial if more consideration is given to losses on house property and other provisions.

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